

**Achievement of Market-Friendly Initiatives and Results Program  
(AMIR 2.0 Program)**

**Funded By U.S. Agency for International Development**

**Financial Markets Forum  
Training Material**

Final Report

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*This report was prepared by Stephen Strauss, James Dry and Ina Paskaleva, in collaboration with Chemonics International Inc., prime contractor to the U.S. Agency for International Development for the AMIR Program in Jordan.*

## **Data Page**

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Investor

Intermediary

Investment Bank

Retail Investor

Securities

## **Abstract**

The Forum aimed to bring together knowledgeable participants in Jordan's financial markets to discuss topics pertinent to the future development of Jordan's financial markets (especially its corporate bond market) and make specific recommendations for action to be taken. The Forum Report, prepared by the AMIR consultants as a summary of conclusions reached by the Forum participants, makes recommendations for action in nine areas. The recommendations aim to encourage the development of new debt instruments, enhance involvement of key investor groups, introduce new categories of bond issuers, and initiate development of more active market mechanisms to broaden and deepen the country's fixed-income debt markets, an important source of capital for the country's development.

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- a. Republic of Bulgaria Mortgage-Backed Bonds Act**
- b. Republic of Bulgaria Law for Public Offering of Securities**
- c. Republic of Bulgaria Special Purpose Investment Companies Law**

## **Executive Summary**

It is widely believed in Jordan's financial community that there is a need and an opportunity to broaden and deepen the country's financial markets, and in particular the fixed-income debt instrument markets by expanding the range of bond instruments, issuers, investors and intermediary institutions. To respond to this need, the AMIR Program and the Association of Banks in Jordan co-sponsored a Financial Markets Forum, held on February 9th and 10th 2004, to bring together representatives of major institutions with an interest in developing the bond markets in Jordan. The Forum, which was held on the premises of the Association of Banks in Jordan, was attended by 75 financial market executives from more than 30 organizations including senior managers of major commercial banks, investment banks, other financial institutions including the Social Security Investment Unit and the Jordan Mortgage Refinance Corporation, as well as officials from the Central Bank of Jordan, the Ministry of Finance, the Jordan Securities Commission and the Amman Stock Exchange. Officials from the USAID Mission to Jordan and the AMIR Program also attended.

The Forum participants reviewed Jordan's current fixed income market; identified the issuers, intermediaries and investors in fixed income instruments; evaluated the legal and regulatory policies that govern the market; and identified strategies to improve Jordan's market. During the first day of the Forum, presentations by AMIR consultants covered a full range of issues relating to corporate bond markets, both in Jordan and with examples from other emerging markets. Forum participants identified a number of issues pertinent to the development of the bond markets in Jordan. During the second day of the Forum, participants discussed in detail the issues and problems raised during the Day One discussion and reached some specific conclusions and recommendations on action to be taken.

This Forum Report summarizes the conclusions reached by the Forum participants and provides recommendations in following areas:

Education of Issuers (Company Financial Managers): The Forum recommended programs to broaden the awareness and knowledge of company financial managers, including the possibility of issuing corporate bonds.

Mortgage Bond Law- Legal Framework Permitting Pledge of Collateral (including Mortgages) to Bondholders: The Forum recommended specific action to permit the introduction of a variety of new instruments and issuers into the market, including the need for a Mortgage Bond Law.

Commercial Paper: The Forum recommended the development of this debt instrument.

Procedures for Approving Bond Prospectus: The Forum recommended specific steps to achieve greater flexibility in the prospectus approval process.

Credit Rating Agency: The Forum recommended serious study of the creation of a domestic credit rating agency for public issuers of bonds.

Developing a Government Securities Market (Bond Pricing and Yield Curve): The Forum made specific recommendations to strengthen the government bond market.

Insurance and Pension Funds Sectors: The Forum recommended steps to encourage greater involvement of these investor pools in the financial markets.

Retail Investors: The Forum recommended ways to make the financial markets more attractive and accessible to individual investors in Jordan.

## **FORUM REPORT**

The two-day Financial Markets Forum, held on February 9th and 10th 2004, was co-sponsored by the Association of Banks in Jordan in cooperation with the USAID-funded AMIR Program. Seventy-five financial market executives from more than 30 organizations gathered to discuss strategies aimed at improving Jordan's nascent corporate bond market.

Attending the Forum were senior managers of major commercial banks, investment banks, other financial institutions including the Social Security Investment Unit and the Jordan Mortgage Refinance Corporation, as well as officials from the Central Bank of Jordan, the Ministry of Finance, the Jordan Securities Commission and the Amman Stock Exchange. Officials from USAID and the AMIR Program also attended.

Mr. Ali Al-Husary, Board Member of the Association of Banks in Jordan, and Chairman and Chief Executive Officer of the Export and Finance Bank, opened the Forum. In his opening remarks, Mr. Al-Husary recommended that the Forum examine the following three issues: (1) developing an "investment culture" among bond issuers, intermediaries and investors in Jordan; (2) introducing a domestic credit rating agency to provide credit ratings to issuers of publicly-traded debt; and (3) improving the primary and secondary markets for Government of Jordan debt securities.

The Forum participants reviewed Jordan's current fixed income market; identified the issuers, intermediaries and investors in fixed income instruments; evaluated the legal and regulatory policies that govern the market; and identified strategies to improve Jordan's market.

The Forum schedule is attached. The Forum's schedule was organized as follows:

Day One: AMIR Consultant presentations covering a full range of issues relating to corporate bond markets, both in Jordan and with examples from other emerging markets, with active discussion by Forum participants who identified a number of issues pertinent to the development of the bond markets in Jordan.

Day Two: Forum participants discussed in detail the issues and problems raised during the Day One discussion and reached some conclusions and recommendations of action to be taken.

The Day Two agenda included the following themes which were discussed in detail:

1. Credit enhancement (reducing and rating corporate bond risks);
2. Developing a broader range of new fixed income debt instruments;
3. Encouraging new bond issues (corporate borrowers);
4. Bringing new investor categories into the market;
5. Pricing: defining the yield curve (Treasury bill and bond markets);
6. Improving liquidity: activating the secondary market;
7. Legal and regulatory steps needed;
8. Recommended actions: items to be included in the Forum Report.



The following are the conclusions reached by the Forum participants.

1. Overview:

The Forum participants concluded that there is a need and an opportunity to expand the range of bond instruments and issuers in the Jordanian financial markets. Participants agreed that there is unmet demand for fixed-income instruments in Jordan given the ample liquidity of many investing institutions. Expanding the supply of bonds will require broadening the types of bonds to include bonds collateralized by mortgage loans and other assets. It will also require making companies better aware of the opportunities for corporate financing through the issuance of debt instruments.

The Forum also concluded that new categories of investors in the corporate bond market, such as private individual savers and various institutions with financial assets, should be encouraged to consider corporate bonds as a valid investment instrument.

2. The Forum came to conclusions involving specific recommendations for action to be taken, as follows:

**Education of Issuers (Corporate Financial Managers):** The Forum recommended that additional Forums be organized by the Association of Banks and the AMIR Program aimed at educating corporate financial managers. The Forum would present various options available to company financial managers for financing the development of their enterprises. Such programs could introduce the concept of corporate bonds (among other financing options) to company financial managers and treasurers who are not well aware of the possibilities offered by this debt instrument.

**Mortgage Bond Law: Legal Framework Permitting Pledge of Collateral (including Mortgages) to Bondholders:**

The Forum concluded that new legislation is necessary to establish a clear and workable framework for pledging collateral (including mortgages) as security for bond issues. As in other markets, pledging collateral to back corporate bonds should become a real and practical option in Jordan. Such collateral would typically include real property and financial receivables such as mortgage loans or escrow accounts.

Currently certain procedures exist, but they are not workable in practice since the existing legal framework does not permit pledges of assets in favor of a changing pool of bondholders, nor the pledge of a fluctuating amount of assets (such as escrow accounts, or mortgage loans where there may be substitutability). The Forum noted that similar problems existed in other emerging financial markets, such as Bulgaria. With assistance from USAID, new legislation was passed in Bulgaria which clearly permits the pledging of various forms of collateral to back corporate and mortgage-backed bonds.

The Forum recommended developing a proposal for new legislation to clearly permit collateral of various asset categories to be pledged in favor of bondholders. Models from other countries should be examined for applicability, with a view to preparing a legal framework and legislative language consistent with Jordanian law. This effort should result in the drafting of enabling legislation.

The Forum also recommended establishing a legal framework to permit special purpose vehicles to issue bonds collateralized by specific categories of assets such as mortgage loan receivables, among others.

**Commercial Paper:** The Forum concluded that commercial paper, as a form of fixed-income corporate debt security for short tenors up to 12 months, should be encouraged in the Jordanian market. To permit the development of this instrument, the Forum recommended the adoption of a regulatory framework which (1) clarifies the definition of commercial paper (perhaps by adopting the phrase “financial notes” to distinguish this fixed-income instrument from other forms of “commercial” promissory notes commonly used in Jordan); (2) clarifies the regulatory supervision of commercial paper issues, bringing them under the supervision of the Jordanian Securities Commission; and (3) eases the burden on issuing and trading this instrument by exempting it from the stamp tax applicable to “commercial” promissory notes.

The regulatory framework for commercial paper and the new Securities Law of 2002 will include Bylaws which are currently being drafted. The above clarifications regarding commercial paper should be included in these Bylaws. The Bylaws should also include a clarification that public issues of commercial paper should be approved by the Jordan Securities Commission, and that private placements (which are not public issues) of both commercial paper and corporate bonds do not require the approval of the Jordan Securities Commission.

**Procedures for Approving Bond Prospectus:** The Forum recommended that the regulatory procedures for the approval of offering prospectuses by the Jordanian Securities Commission should be made more flexible to permit an initial prospectus to be approved without specifying the exact amount of the issue or the exact coupon rate of interest to be applied to the bond issue. This would permit “book-building” by the issue manager in placing the prospective bond issue with potential investors, which requires a certain degree of flexibility in establishing the final pricing of the bond to “clear the market” and place a higher total issue amount. The initial prospectus would be followed by the final prospectus stipulating the final amount and coupon rate of the issue.

**Credit Rating Agency:** The Forum concluded that a credit rating agency with the professional capacity, independence and credibility to rate issuers of corporate bonds is needed in Jordan. Such a rating agency would provide a local rating scale to facilitate the issuance of new bonds and assist in investment decisions by all investor categories. The Association of Banks in Jordan could be the focal point for facilitating the creation of a domestic credit rating agency. The manner of launching this agency and the framework for its operations should be studied in detail.

A feasibility study should be done which examines the various ownership options, recommends regulatory procedures, and determines how a local rating agency in Jordan could apply international rating standards. For example, one ownership option could be a corporate entity with start-up capital provided by commercial and investment banks and other interested institutions.

**Developing a Government Securities Market (Bond Pricing and Yield Curve):**

The Forum concluded that there needs to be a better yield-curve framework within which a bond market can operate, both for pricing of primary issues, and for secondary market trading. The Forum therefore would welcome a Treasury bond market with the following characteristics:

- (1) A more regular stream of Treasury bond issues bearing a greater variety of maturities;
- (2) A primary dealer auction system, in which (a) the primary dealers would ensure an active secondary market, accessible to all categories of investors including private individuals, and (b) primary dealers would include non-bank institutions as well as commercial banks, willing and able to assume the responsibilities of a primary dealer and market-maker.

**Insurance Sector:** The Forum encourages the Insurance Commission to develop insurance regulations which will provide a framework for insurance companies to invest in various types of instruments including corporate bonds. The insurance sector's total investment portfolio, while currently small, is expected to grow substantially during the next few years.

**Pension Fund Sector:** The Forum encourages an examination of the current investment activities of provident funds and other managers of employee pension savings plans. In addition, an examination of the possibilities for development of the private pension fund sector is recommended, with a view to establishing a clear regulatory and procedural framework for a private pension sector. In other emerging markets, the private pension sector represents a major pool of investment funds in the debt security markets. It would be desirable for the disclosure requirements in the relevant private pension fund regulations to require information to be provided about the size, management and investments of each private pension fund or company provident fund.

**Retail Investors:** The Forum recommended making the bond markets more accessible to retail (private) investors in a variety of ways including:

- (1) Lowering the unit par value of bond issues aimed at the smaller investor, for example to JD 1,000.
- (2) Making secondary market trading in Government of Jordan bonds more accessible to the individual investor by adopting a primary dealer system which would permit individuals to access the secondary markets through primary dealers and brokers.
- (3) Encouraging the development of mutual funds as a vehicle for private individuals to invest in fixed-income debt instruments. Clarification of the tax exempt status of mutual funds is necessary.

**Attachment 1: Forum presentations**

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# **FINANCIAL MARKETS FORUM**

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## **OBJECTIVE:**

**TO ASSIST THE DEVELOPMENT OF DEBT  
INSTRUMENTS AND MARKETS IN JORDAN  
BY IDENTIFYING ISSUES AND  
RECOMMENDING ACTIONS**

# FORUM CONTENT

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- ✍ **INSTRUMENTS: THE “PRODUCT”**
- ✍ **ISSUERS: THE “SUPPLY”**
- ✍ **INVESTORS: THE “DEMAND”**
- ✍ **INTERMEDIARIES: MATCHING SUPPLY, DEMAND AND THE PRODUCT**
- ✍ **LEGAL AND REGULATORY ISSUES**
- ✍ **COMPARATIVE EXAMPLES**
- ✍ **CONCLUSIONS AND RECOMMENDATIONS FOR ACTION**

# FORUM AGENDA

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## DAY ONE

- ✍ **PRESENTATION OF ISSUES BY AMIR CONSULTANTS FOR DISCUSSION BY FORUM PARTICIPANTS**
- ✍ **REACH SOME CONCLUSIONS ABOUT JORDAN'S DEBT INSTRUMENT MARKET DEVELOPMENT, AND RECOMMENDATION FOR ACTIONS TO BE TAKEN**



# FORMAT

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## DAY TWO

- ✍ **WORKING SESSION TO DISCUSS IN DETAIL THE FORUM'S CONCLUSIONS, AND TO AGREE ON SPECIFIC RECOMMENDATIONS FOR ACTION**
- ✍ **A "FORUM REPORT" WILL SUMMARIZE THE CONCLUSIONS AND RECOMMENDATIONS, FOR DISTRIBUTION TO ALL FORUM PARTICIPANTS AND TO OTHER INTERESTED PARTIES**

# **FIXED INCOME DEBT INSTRUMENTS: “THE PRODUCT”**

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- ✍ **TYPES OF DEBT ISSUES CURRENTLY IN JORDANIAN MARKET**
- ✍ **WHAT ARE OTHER TYPES OF DEBT INSTRUMENTS? WHAT NEW INSTRUMENTS MIGHT BE DEVELOPED IN JORDAN, WHEN AND HOW ?**
- ✍ **COMMERCIAL PAPER: CURRENT ACTIVITY AND POTENTIAL IN JORDAN**
- ✍ **RISK ENHANCEMENT: WHAT MECHANISMS CAN BE USED ?**
- ✍ **WHAT COLLATERAL AND GUARANTEES ARE, OR SHOULD BE, REQUIRED TO IMPROVE RISKS ?**
- ✍ **LISTING AND TRADING PROCEDURES: ARE THEY SATISFACTORY ?**

# **FIXED INCOME DEBT INSTRUMENTS: “THE PRODUCT”**

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## **TYPES OF DEBT ISSUES CURRENTLY IN JORDANIAN MARKET**

# **FIXED INCOME DEBT INSTRUMENTS: “THE PRODUCT”**

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**WHAT ARE OTHER TYPES OF  
DEBT INSTRUMENTS ?**

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DEVELOPED IN JORDAN, WHEN AND  
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**COMMERCIAL PAPER:  
CURRENT ACTIVITY AND POTENTIAL  
JORDAN**

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# **FIXED INCOME DEBT INSTRUMENTS: “THE PRODUCT”**

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**LISTING AND TRADING PROCEDURES  
ARE THEY SATISFACTORY ?**



# ISSUERS: THE “SUPPLY” OF DEBT INSTRUMENTS

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- ✍ WHICH TYPES OF ENTITIES SHOULD ISSUE DEBT INSTRUMENTS ?
- ✍ WHAT ARE APPROPRIATE CIRCUMSTANCES, OR PURPOSES, FOR ISSUING BONDS ?
- ✍ COMPARISON OF BONDS WITH OTHER FORMS OF DEBT: WHEN IS IT APPROPRIATE TO ISSUE BONDS INSTEAD OF BORROWING FROM BANKS ?
- ✍ WHAT CATEGORIES OF ISSUERS ARE CURRENTLY ELIGIBLE TO ISSUE BONDS IN JORDAN ?
- ✍ PRICING OF BOND ISSUES: WHAT PARAMETERS SHOULD APPLY? WHAT BENCHMARKS AND YIELD-CURVE PARAMETERS CURRENTLY EXIST OR SHOULD EXIST IN JORDAN ? WHAT IS GOVERNMENT’S ROLE ESTABLISHING SUCH PARAMETERS ?

# **ISSUERS: THE “SUPPLY” OF DEBT INSTRUMENTS**

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## **ISSUERS: THE “SUPPLY” OF DEBT INSTRUMENTS**

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**COMPARISON OF BONDS WITH OTHER  
FORMS OF DEBT: WHEN IS IT  
APPROPRIATE TO ISSUE BONDS  
INSTEAD OF BORROWING FROM  
BANKS ?**

# **ISSUERS: THE “SUPPLY” OF DEBT INSTRUMENTS**

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**WHAT CATEGORIES OF ISSUES ARE CURRENTLY ELIGIBLE TO ISSUE BONDS IN JORDAN ?**

## **ISSUERS: THE “SUPPLY” OF DEBT INSTRUMENTS**

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**PRICING OF BOND ISSUES:  
WHAT PARAMETERS SHOULD APPLY?  
WHAT BENCHMARKS AND  
YIELD-CURVE PARAMETERS  
CURRENTLY EXIST OR SHOULD EXIST  
IN JORDAN ?  
WHAT IS GOVERNMENT’S ROLE IN  
ESTABLISHING SUCH PARAMETERS ?**

# US CORPORATE BONDS: TRENDS IN SPREADS AND RISKS

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SPREAD OVER US TREASURIES:	12/02	12/03
INVESTMENT GRADE	OVER 300	UNDER 100
HIGH-YIELD (“Junk”)	1,600 TO 1,900	400 TO 500
H-Y DEFAULT RATE	23 %	5 %

# INVESTORS: THE “DEMAND” FOR DEBT INSTRUMENTS

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- ✍ **WHICH CATEGORIES OF INVESTORS CURRENTLY INVEST IN DEBT INSTRUMENTS IN JORDAN ? WHAT ARE THEIR OBJECTIVES ?**
- ✍ **WHAT INVESTOR CATEGORIES SHOULD INVEST IN PUBLICLY-LISTED DEBT INSTRUMENTS ? WHAT IS NEEDED TO ATTRACT NEW INVESTOR CATEGORIES ?**
- ✍ **ACTIVITIES OF FUND MANAGERS IN JORDAN: WHAT ARE THEIR OBJECTIVES ? WHAT INVESTMENT CRITERIA DO THEY APPLY ?**
- ✍ **WHAT ARE THE KEY CRITERIA FOR ANY INVESTOR DECISION (PRICING, LIQUIDITY, RISK. ETC) ? WHAT CRITERIA SHOULD THEY APPLY AND HOW TO EVALUATE THEM ?**
- ✍ **WHAT RISK ASSESSMENT MECHANISMS, IF ANY, SHOULD BE DEVELOPED (E.G. CREDIT RATING AGENCIES) ?**



# **INVESTORS: THE “DEMAND” FOR DEBT INSTRUMENTS**

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**WHICH CATEGORIES OF INVESTORS  
CURRENTLY INVEST IN DEBT  
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# **INVESTORS: THE “DEMAND” FOR DEBT INSTRUMENTS**

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**WHAT INVESTOR CATEGORIES  
SHOULD INVEST IN PUBLICLY-LISTED  
DEBT INSTRUMENTS ? WHAT IS  
NEEDED TO ATTRACT NEW INVESTOR  
CATEGORIES ?**

# **INVESTORS: THE “DEMAND” FOR DEBT INSTRUMENTS**

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**ACTIVITIES OF FUND MANAGERS IN  
JORDAN: WHAT ARE THEIR  
OBJECTIVES ? WHAT INVESTMENT  
CRITERIA DO THEY APPLY ?**

# **INVESTORS: THE “DEMAND” FOR DEBT INSTRUMENTS**

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**WHAT ARE THE KEY CRITERIA FOR INVESTOR DECISIONS (PRICING, LIQUIDITY, RISK. ETC) ? WHAT CRITERIA SHOULD APPLY AND HOW TO EVALUATE THEM ?**





# **INVESTORS: THE “DEMAND” FOR DEBT INSTRUMENTS**

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**WHAT RISK ASSESSMENT MECHANISMS, IF ANY, SHOULD BE DEVELOPED (E.G. CREDIT RATING AGENCIES) ?**

# **INTERMEDIARIES (INVESTMENT BANKS): MATCHING SUPPLY, DEMAND AND PRODUCT**

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-  **WHAT IS THE ROLE OF INTERMEDIARIES | DEVELOPING JORDAN'S DEBT INSTRUMENTS AND MARKETS? WHAT SHOULD THEIR ROLE BE ?**
-  **WHAT CATEGORIES OF INTERMEDIARIES OPERATE NOW AND POTENTIALLY ?**
-  **WHAT IS NEEDED TO FURTHER DEVELOP THE NUMBER AND ROLE OF INTERMEDIARIES ?**
-  **HOW TO STIMULATE ACTIVITY IN SECONDARY MARKETS AND IMPROVE MARKET LIQUIDITY ?**

# **INTERMEDIARIES (INVESTMENT BANKS): MATCHING SUPPLY, DEMAND AND PRODUCT**

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**WHAT IS THE ROLE OF  
INTERMEDIARIES IN DEVELOPING  
JORDAN'S DEBT INSTRUMENTS AND  
MARKETS?  
WHAT SHOULD THEIR ROLE BE ?**

# **INTERMEDIARIES (INVESTMENT BANKS): MATCHING SUPPLY, DEMAND AND PRODUCT**

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# **INTERMEDIARIES (INVESTMENT BANKS): MATCHING SUPPLY, DEMAND AND PRODUCT**

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**HOW TO STIMULATE ACTIVITY IN SECONDARY MARKETS AND IMPROVE MARKET LIQUIDITY ?**

# LEGAL AND REGULATORY ISSUES

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- ✍ **WHAT REGULATORY FRAMEWORK CURRENTLY GOVERNS DEBT INSTRUMENT ISSUING AND TRADING IN JORDAN (REGS APPLYING TO ISSUERS, INVESTORS, INTERMEDIARIES) ?**
- ✍ **WHAT ISSUES OR OBSTACLES CONSTRAIN FURTHER DEVELOPMENT OF DEBT INSTRUMENTS AND MARKETS ?**
- ✍ **WHAT ACCOUNTING AND FINANCIAL DISCLOSURE RULES APPLY, OR SHOULD APPLY, TO PUBLIC OR PRIVATE BOND OR COMMERCIAL PAPER ISSUES**

# **LEGAL AND REGULATORY ISSUES**

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**WHAT REGULATORY FRAMEWORK  
CURRENTLY GOVERNS DEBT  
INSTRUMENT ISSUING AND TRADING  
JORDAN (REGS APPLYING TO  
ISSUERS, INVESTORS,  
INTERMEDIARIES) ?**

# **LEGAL AND REGULATORY ISSUES**

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**WHAT ISSUES OR OBSTACLES  
CONSTRAIN FURTHER DEVELOPMENT  
OF DEBT INSTRUMENTS  
AND MARKETS ?**

## **LEGAL AND REGULATORY ISSUES**

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**WHAT ACCOUNTING AND FINANCIAL  
DISCLOSURE RULES APPLY, OR  
SHOULD APPLY, TO PUBLIC OR  
PRIVATE BOND OR  
COMMERCIAL PAPER ISSUES ?**

# ***COMMERCIAL PAPER***

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THE BEGINNINGS OF A  
FIXED INCOME  
MARKET?

James R. Dry

## ***WHAT IS CP?***

✍ ST unsecured promissory notes issued by “blue chip” companies.

✍ Notes are redeemed or rolled

✍ Annual renewal of facility(Kenya).



# ***WHAT IS CP USED FOR? WHO CAN ISSUE?***

✍ Used for ST financing matching cash flow needs of corporation

✍ Initially, only companies listed on stock exchange (Kenya)

✍ No restrictions, but only well known companies (US)

## ***WHY ISSUE?***

1. Less Expensive
2. Quick and Easy
3. Measure of Financial Independence

## ***LESS EXPENSIVE***

### UP FRONT SAVINGS

- ✍ No commitment fee (for example,  
 $1\% \times \text{DH } 5,000,000 = \text{DH } 50,000$ )
- ✍ No legal fees/stamp duty (for examp  
 $1\% \times \text{DH } 5,000,000 = \text{DH } 50,000$ )

## ***INTEREST RATE SAVINGS***

✍ CP priced slightly above Treasury bill of same tenor (floor)

✍ CP also priced below prevailing O/D (ceiling)

For example, O/D = 10%

$$\text{CP} = 7\% + 1\% \text{ Fee}$$

$$\text{91-day T-bill} = 5\%$$

$$\text{Savings} = 2\% \times \text{DH } 5,000,000 = 100,000$$

## ***INTEREST SAVINGS (Cont.)***

### Compound Interest Savings

There is also less compounding.

✍ Effective cost of 10% O/D is 10.47% (12x)

✍ Effective cost of 7% CP is 7.19% (4x)

# ***REGULATORY ENVIRONMENT***

In absence of Credit Rating Authorities, regulatory authorities must step in. In Kenya, CMA established following min. requirements for issuance:

- ✍ Profit in 2 of last 3 years
- ✍ Paid up capital of \$1M
- ✍ Debt equity ratio less than 4:1
- ✍ Cash flow from operations/total debt  $>40\%$

## ***REGULATORY (Cont.)***

Without meeting requirements, CP only issued with 100% guarantee from bank or insurance company.

✍ This also appropriate for companies which do not want to disclose financials like GM

✍ Regulatory fee 0.25% (1/2 2<sup>nd</sup> year)

# ***PROSPECTUS OR INFORMATION MEMORANDUM***

IM must have:

1. Legal Notice

2. Term Sheet

3. Local currency,  
US\$, or both

4. Parties to the  
issue:

- Arranger

- Placement Agent

- Registrar

- Receiving Bank

5 Financials

6 Ration Analysis

7 Accountants  
Report

8 History and Risks



## ***PLACEMENT***

- ✍ Fees – Vary by size of issue, but...  
approx 0.5% - .75% for guaranteed issue  
and 1% - 1.5% for unguaranteed.
- ✍ IPO – Road show, launch, tombstone
- ✍ Adm – Telephone deals, written fax  
confirmations (w/in 15 min) – certificate  
in 1 week
- ✍ Issuance – Varies, but 25% 30 days..

# ***REGISTRAR SERVICES***

Registrar maintains:

- Investor name
- Date and amt purchased/maturity
- Nominal yield agreed
- Tax on interest to be w/held if appropriate
- Number of promissory note (certificate

Used by agent to contact 1 week prior to maturity

## ***DRAWBACKS***

- ✍ Tied to T-Bills which can change rapidly (Ex. in Sept 97 in Kenya when IMF w/drew, T-bill rose to 25% from 17% in 1 week but O/Ds still at 23%)
- ✍ Rapid deterioration of company's financial condition (CP issuers report results semi-annually)

## ***SUMMING UP***

✍ In US and Europe, most major companies have CP and O/Ds

✍ CP programs nursery for LT bonds and other securities (builds clientele, familiarity with securities eg. Comcraft)

✍ Forward looking banks see new fee business as: Arranger, Placement Agent, Registrar, Receiving Bank, Guarantor.

# FINANCIAL MARKETS FORUM

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## DEBT INSTRUMENTS DEVELOPMENT IN OTHER EMERGING MARKETS

EXAMPLE:

**BULGARIA SINCE 1991**

Ina Paskaleva

# EVOLUTION OF FINANCIAL MARKETS

## Example Of Bulgaria

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 **COUNTRY COMPARISON**

 **DEVELOPMENT OF DEBT INSTRUMENTS  
AND MARKETS SINCE 1991**

 **RECENT DEVELOPMENTS OF POSSIBLE  
RELEVANCE TO JORDAN**

# HISTORY

## Comparison Jordan And Bulgaria

HISTORICAL PERIODS	JORDAN	BULGARIA
Macedonia (Alexander and successors)/ Roman Empire/ Byzantine Empire	From 333 BC  to 636 AD	From 363 BC  to 681 AD
Turkish Rule/Ottoman Empire	11 <sup>th</sup> Century to 1918	1327 to 1878/1904
Two thirds of history in common since 333 BC		

# BASIC DATA (2002)

## Country Comparison

Geographic and Demographic Parameters	JORDAN	BULGARIA
Area (Square Km)	89,329	111,002
Population (Million)	5.3	7.9
Population Density (per Square Km)	60	70.9
Population Growth Rate	2.8%	0%



# BASIC DATA (2002)

## Country Comparison (Continued)

Macroeconomic Parameters	JORDAN	BULGARIA
GDP – nominal, at current prices (Billion)	USD 9.3	EUR 6.6
Real GDP growth rate	4.9%	4.8%
GDP per Capita	USD 1,741	EUR 2,100
Inflation (consumer price index change)	1.8%	5.8%

## BASIC DATA (2002)

### Country Comparison (Continued)

Macroeconomic Parameters	JORDAN	BULGARIA
Government Debt (%of GDP)	101.6%	53%
Government Budget Deficit (%of GDP)	3.9%	0.6%
Official Monetary Reserves	USD 3.5 B	EUR 4.2 B
Currency	JD	Lev (Currency Board system: Lev fixed by law to DM/EURO since 1997)

# Evolution Of Debt Instrument Markets I Bulgaria Since 1991

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## Capital Markets Infrastructure:

- 1991 Securities Commission established
- 1992 First Securities Law passed
- 1997 Bulgaria Stock Exchange established
- 1997 Central Depository established
- 2000 First public corporate bond issued
- 2000 First municipal bond issued
- 2001 Mortgage bond law passed
- 2001 First mortgage bond issued
- 2002 Bond Collateralization Law (amendments) passed
- 2003 Commission of Financial Supervision established
- 2003 Special Purpose Vehicle (SPV) law passed
- 2003 First SPVs approved by Commission of FS

# USAID Capital Markets Programs In Bulgaria

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## 1998 – 1999: USAID STATE SECURITIES COMMISSION PROJECT

- ✍ INFRASTRUCTURE OF THE STATE SECURITIES COMMISSION AND STOCK EXCHANGE
- ✍ INTERNAL RULES AND REGULATIONS OF THE STATE SECURITIES COMMISSION

## 1998 - 2001: USAID BULGARIAN CAPITAL MARKETS PROJECT (PHASE I)

- ✍ EQUIPPED BULGARIAN STOCK EXCHANGE
- ✍ DEVELOPED REGULATIONS AND TRADING RULES

# USAID Capital Markets Programs In Bulgaria (Continued)

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## 2000-2002: USAID BULGARIAN CAPITAL MARKETS DEVELOPMENT PROJECT (PHASE II)

- ✍ ACTION TO SUPPORT DEVELOPMENT OF BOND INSTRUMENTS, ISSUERS, INTERMEDIARIES, AND INVESTOR CATEGORIES.
- ✍ ACTION TO SUPPORT NEW LAWS (MORTGAGE BONDS, COLLATERALIZATION OF BONDS)

## 2000-2003: USAID BULGARIAN CAPITAL MARKET REGULATIONS PROJECT

- ✍ PROPOSALS ON THE DRAFT LAW ON PUBLIC OFFERING OF SECURITIES
- ✍ PROPOSALS ON CAPITAL MARKET FRAUD PROVISIONS (AMENDED IN THE CRIMINAL LAW)

# USAID Capital Markets Programs In Bulgaria (Continued)

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- ✍ **PILOT PROJECTS FOR LAUNCHING CORPORATE BONDS AND MORTGAGE BONDS**
- ✍ **TECHNICAL ASSISTANCE TO THE CENTRAL DEPOSITORY**
- ✍ **BULGARIAN PENSION REFORM PROJECT**
- ✍ **ESTABLISHMENT OF THE CENTRAL PLEDGE REGISTRY**
- ✍ **JUDICIAL REFORM PROJECT**

# Types of Issuers, Investors and Intermediaries

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## AS OF DECEMBER 2003:

- ✍ **COMMERCIAL BANKS – 27 FOREIGN AND DOMESTIC**
- ✍ **PENSION FUNDS – 8 FOREIGN AND DOMESTIC**
- ✍ **INSURANCE COMPANIES – 4 LIFE AND 8 GENERAL INSURANCE**
- ✍ **FINANCIAL BROKERAGE HOUSES – 20 ACTIVE BROKERS (OF WHICH FIVE ARE INVESTMENT BANKS)**
- ✍ **PUBLIC COMPANIES – 10 MOST ACTIVELY TRADED ON THE BSE, 100 LISTED SHARES (10 ACTIVELY TRADED “, 8 LISTED BOND ISSUES**

# Instruments, Issuers And Investors

INSTRUMENT	ISSUER TYPE	INVESTOR GROUP
Corporate Bonds	Companies: 10 issues Banks: 1 Eurobond 4 Local Issues	Life Insurance, Pension Funds, Banks, Local Private Investors
Commercial Paper	1 Corporate Issue	Bank
Municipal Bonds	Municipalities: 1 Eurobond Issue 4 Local Issues	Life Insurance, Pension Funds, Banks, Local Private Investors
Mortgage Bonds	Banks 9 issuers 12 issues	Life Insurance, Pension Funds, Banks, Local Private Investors
Asset-backed – issued bonds (real estate and receivables)	None to date 3 issues planned	To be determined



# Government Bond Issues

## Eurobonds

prices	<i>buying</i>	<i>selling</i>
2,007	110.30	110.93
2,010	103.46	104.28
2,013	114.87	115.48
2,015	120.14	121.05
2,018	99.80	101.61

## T-bills

yield	<i>buying</i>	<i>selling</i>
3 months	1.69%	1.50%
1 year	3.76%	2.76%
3 years	4.31%	3.81%
5 years	4.80%	4.30%
7 years	5.19%	4.69%
10 years	5.78%	5.28%

## Brady and ZUNK

prices	<i>buying</i>	<i>selling</i>
FLIRB	98,81	98,81
DISC	98,88	98,88
IAB	98,06	98,06
USD ZUNK	88,00	88,00
EUR ZUNK	88,00	88,00

# Institutional Bond Issues

yield	buying	selling
Post Bank (leva)	6,30%	5,30%
B A CB (EUR)	6,00%	4,50%
B A CB II (EUR)	6,00%	5,00%
B A CB III (EUR)	6,65%	5,65%
A Ilianze Bank (\$)	5,95%	5,30%
Post Bank II (leva)	5,65%	5,00%

yield	buying	selling
UBB (leva)	6,00%	5,1
UnionBank (USD)	7,55%	6,1
Kaolin A D (EUR)	7,40%	6,1
B A CB (USD)	5,70%	5,1
CCB (leva)	7,10%	6,1
PETROL A D (leva)	8,35%	7,1

# MORTGAGE BOND ISSUES

Issuing Bank	Date of Issue	Date of maturity	Interest Rate	Issue Amount
BACB	01.08.2001	01.08.2004	7.750%	3242000 EUR
FIB	25.10.2001	25.10.2003	7.800%	5000000 EUR
SIBANK	20.03.2002	20.03.2004	7.250%	1674610 BGN
BACB	28.03.2002	28.03.2005	7.000%	5500000 EUR
Post bank	22.05.2002	22.05.2005	7.625%	12000000 BGN
UBB	20.06.2002	20.06.2005	7.500%	11719000 BGN
CCB	16.12.2002	16.12.2004	8.000%	5000000 BGN
BACB	31.01.2003	31.01.2008	7.000%	10000000 EUR
Procredit bank	15.04.2003	15.04.2006	7.125%	5000000 + 5000000BGN
Bulgaria Invest	21.05.2003	21.05.2006	6.125%	7000000 EUR
Unionbank	23.05.2003	23.05.2006	7.700%	5000000 EUR
Post bank	30.06.2003	30.06.2006	5.625%	10000000 EUR

# Strengths and Weaknesses In Debt Instrument Markets in Bulgaria

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## **STRENGTHS:**

- RANGE OF INSTRUMENTS
- ACTIVE, GROWING INTERMEDIARY (INVESTMENT BANKING) COMMUNITY
- LEGAL, REGULATORY AND INSTITUTIONAL FRAMEWORK NOW IN PLACE

## **WEAKNESSES:**

- LACK OF PLACEMENT CAPACITY WITH RETAIL INVESTORS
- LACK OF FOREIGN INVESTOR INTEREST
- STILL-WEAK SECONDARY TRADING

# Recent Evolutions Of Possible Relevance To Jordan

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 **COLLATERALIZATION OF BONDS**

 **MORTGAGE BOND LAW AND ISSUES**

 **SPECIAL PURPOSE VEHICLES  
(SECURITIZATION)**

# Collateralization Of Bonds: Enhancing the Risks of Corporate Bonds

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## **SECURITIES LAW WAS AMENDED IN 2002**



 **ESTABLISHED PROCEDURE FOR PLEDGING COLLATERAL IN FAVOR OF BONDHOLDERS**

 **THE AGENT OF THE BONDHOLDERS, A COMMERCIAL BANK, IS THE BENEFICIARY OF REGISTERED PLEDG**

# Mortgage Bond Law

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**ENACTED IN 2001 AS NEW LAW:**

-  **COMMERCIAL BANKS MAY ISSUE BONDS BACKED BY MORTGAGE LOAN RECEIVABLES PLEDGED TO BONDHOLDERS**
-  **ACTIVELY USED: 12 MORTGAGE BOND ISSUES TO DATE**

## Securitization

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### **SPECIAL PURPOSE VEHICLE (SPV) LAW ENACTED IN 2003:**

- ✍ SPV'S MAY INVEST EITHER IN REAL PROPERTY, OR IN RECEIVABLES (ANY TYPES), BUT NOT BOTH**
- ✍ SPV'S MAY ISSUE BONDS TO THE PUBLIC SECURED BY THE PROPERTY OR THE RECEIVABLES, PLEDGED TO THE BONDHOLDERS**



# KENYA


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EMERGING  
MARKET



## 1990 – THE WAY IT WAS

 JRD – Brief – Help Reinvigorate  
Nairobi Stock Exchange

 Loan Limits for International  
Companies (“bring your own  
capital”)

 Interest Rate Caps

 Foreign Exchange Controls

# FOREIGN EXCHANGE CONTROLS

✍ All Forex Turned Over to Central Bank

✍ Import Licensing

✍ Internationals had “Blocked Accounts”


(for example, ALICO and Exxon used local currency to finance Exxon Plaza)

# **1993 INTERIM SOLUTION FOREIGN EXCHANGE CERTIFICATES (FOREX C's)**

- ✍ Banks collected dollar checks and deposited funds with CBK and Forex Certificates issued
- ✍ Certificate entitled owner to purchase \$1000, \$5000, or \$10,000 in dollars
- ✍ Value fluctuated between 4 and 30 Kenyan cents per dollar
- ✍ Heavy trading on NSE




## 1994 - CERTIFICATES CANCELLED

 Central Bank began issuing  
Forex Cs without funds on  
hand...CRISIS...Certificates  
Cancelled

 Multinationals left holding bag

# CURRENCY DECONTROLLED

 Currency Decontrolled

 Kenya shilling “spiked” from 45 per dollar to 73 per dollar

 91-day Treasury Bills rose to 35% per annum



# STOCK EXCHANGE

- ✍ Nairobi Stock Exchange rose 400% as foreign “hot” money came in
- ✍ Tapered off as foreigners found:
  - 1) Could not buy sufficient quantities
  - 2) Could not sell stocks
  - 3) Settlement took weeks/months
  - 4) NOW, Foreign ownership limited

# TREASURY BILLS/BONDS

- ✍ 1994 – 2000 Central Bank financed deficits with 91-day Treasury Bills
- ✍ Massive current debt of Ksh 250 Billion (approx. \$3.3 Billion)
- ✍ 91-Treasury Bills averaged 20-25% p annum for years
- ✍ Treasury Bonds not purchased (CBK refused to pay stockbroker commission)





## NEW CBK GOVERNOR

- ✍ New Governor focused on shifting domestic deficit to LT Bonds – paid commissions to “hungry” stockbrokers
- ✍ Shift of almost entire Ksh 250B to 1, 5, and 10 year bonds
- ✍ Interest rates on 91-day T-Bill fell to approx. 2% today
- ✍ 5 year T-Bond pays approx. 6% p.a.

# TODAY IN KENYA

- ✍ Yield curve established
- ✍ All major banks now have profitable Treasury Bond dealing desks
- ✍ Several semi-guaranteed (Citibank, Standard Chartered/Barclays) corporat bonds issues listed

# THE CASE OF PARMALAT

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# PARMALAT

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- POSSIBLY THE MOST “MULTINATIONAL” CORPORATE BOND CRASH EVER, AND PERHAPS THE BIGGEST.
- DECLARED BANKRUPT IN DECEMBER 2003 AFTER EUR 4 B “CASH” ON BALANCE SHEET FOUND TO BE NONEXISTENT
- DEBT ESTIMATE NOW EUR 14.3 B (\$ 18 B).
- ASSETS MAY BE LESS THAN \$ 2 B.
- BONDS ISSUED: US \$ 10 BILLION DEBT PLACED SINCE 1997 (\$ 1 B IN 2003)
- RATED BONDS OUTSTANDING: \$ 7.2 BILLION

# PARMALAT

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## BOND ISSUE MANAGERS:

- ✍ **LEADING BANKING INSTITUTIONS  
(INCLUDING 1 GERMAN AND 3 AMERICAN  
BANKING GROUPS)**

## BONDHOLDERS:

- ✍ **1/3 ITALIAN (INCLUDING OVER  
100,000 INDIVIDUALS)**
- ✍ **2/3 INTERNATIONAL (LARGE AMOUNTS  
PLACED WITH US INSURANCE AND  
PENSION FUNDS)**

# PARMALAT

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## JURISDICTIONS INVOLVED:

- ✍ **ITALY: CAPITAL MARKET REGULATORS, BANKING SUPERVISION, AND FISCAL AUTHORITIES.**
- ✍ **NETHERLANDS, LUXEMBOURG: ISSUING ENTITY JURISDICTIONS.**
- ✍ **USA (AMONG OTHERS): BOND LISTINGS, MAJOR INVESTORS.**
- ✍ **LEGAL (CRIMINAL FRAUD, BANKRUPTCY) ACTIONS UNDER WAY IN ITALY, USA, NETHERLANDS, LUXEMBOURG, SWITZERLAND, GERMANY, SWEDEN, UK, IRELAND, BRAZIL, VENEZUELA, ECUADOR, CAYMAN IS., SINGAPORE, OTHERS.**

# PARMALAT

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## ENTITIES IN THE CHAIN:

- ✍ **BOND ISSUERS AND RECIPIENTS OF PROCEEDS (MAZE OF PARMALAT ENTITIES)**
- ✍ **BANKS: US, ITALIAN, GERMAN**
- ✍ **INDEPENDENT AUDITORS**
- ✍ **RATING AGENCIES**
- ✍ **INSTITUTIONAL INVESTORS**
- ✍ **INDIVIDUAL INVESTORS**
- ✍ **REGULATORS IN ALL AFFECTED JURISDICTIONS: SECURITIES MARKET REGULATORS, CENTRAL BANKS, FINANCIAL/FISCAL AUTHORITIES**

# PARMALAT

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## OBVIOUSLY UNASKED QUESTIONS:

- ✍ WHAT WAS THE PURPOSE OF THE MANY BONDS ISSUES ?
- ✍ TO WHAT USE WILL THE FUNDS BE PUT (WHERE WILL THE MONEY GO ?)
- ✍ WHAT ARE THOSE HUGE “LIQUID ASSETS” ON THE BALANCE SHEET OF A GROUP WITH HUGE AND GROWING DEBT OBLIGATIONS ?
- ✍ WHAT IS THE RELATION BETWEEN THE UNDERLYING (MILK AND JUICE) BUSINESS AND ALL THAT FINANCING ?



# PARMALAT

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## REASONS IT WAS SO BIG FOR SO LONG:

- ✍ INVESTORS LOOKING ONLY FOR YIELD, FAILING TO APPLY ANALYSIS
- ✍ RATING AGENCIES ASLEEP, DEPENDING ON AUDITORS
- ✍ AUDITORS ASLEEP (OR WORSE), ACCEPTING COMPANY (FALSE) NUMBERS, FAILING TO ASK QUESTIONS
- ✍ ISSUE MANAGERS LOOKING FOR FEES
- ✍ LENDERS “STUFFING” INVESTORS WITH RISK
- ✍ REGULATORS ASLEEP OR WORSE
- ✍ MYSTIFYING CORPORATE LEGAL ENTITY STRUCTURE

# PARMALAT

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## OF ALL THE AFFECTED ENTITIES:

- ✍ **WHO WERE THE PERPETRATORS ?**
- ✍ **WHO WERE THE VICTIMS ?**
- ✍ **WHO KNEW AND KEPT QUIET, AND WERE THEREFORE COMPLICIT ?**
- ✍ **WHO DID NOT KNOW BUT SHOULD HAVE KNOWN AND WERE THEREFORE NEGLIGENT?**
- ✍ **HOW CAN SUCH A CHAIN OF LAPSES BE PREVENTED ?**

# PARMALAT

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## WHAT CONSEQUENCES ARE EMERGING ?

- ✍ **SECURITIES REGULATORS (US AND EUROPE) SEEKING WAYS TO STRENGTHEN FORMAL COOPERATION ACROSS BORDERS**
- ✍ **ITALIAN REGULATORY FRAMEWORK TO BE SHAKEN UP SIGNIFICANTLY, STRENGTHENING THE SECURITIES MARKETS REGULATING BODY**
- ✍ **AUDITING RULES MAY BE SIGNIFICANTLY TIGHTENED IN THE EU (ROTATION OF AUDITORS, RESPONSIBILITIES OF LEAD AUDITOR)**

# PARMALAT

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## LESSONS TO DATE (APPLICABLE TO AN COUNTRY MARKET):

- ✍ **NEED FOR CLEAR REGULATORY AND SUPERVISORY FRAMEWORK, WITH TRIGGERS FOR REMEDIAL ACTION**
- ✍ **MEANINGFUL FINANCIAL DISCLOSURE AND AUDITING REQUIREMENTS**
- ✍ **DUE DILIGENCE BOTH BY INVESTORS AND BY ISSUE MANAGERS, TO DISCIPLINE ISSUERS.**

# FINANCIAL MARKETS FORUM: DAY TWO AGENDA

## THEMES :

1. CREDIT ENHANCEMENT (REDUCING AND RATING CORPORATE BOND RISKS)
2. DEVELOPING A BROADER RANGE OF NEW FIXED INCOME DEBT INSTRUMENTS
3. ENCOURAGING NEW BOND ISSUERS
4. BRINGING NEW INVESTOR CATEGORIES TO THE MARKET
5. PRICING: DEFINING THE YIELD CURVE (TREASURY BILL AND BOND MARKETS)
6. IMPROVING LIQUIDITY:  
ACTIVATING THE SECONDARY MARKET
7. LEGAL AND REGULATORY STEPS NEEDED
8. RECOMMENDED ACTIONS: THE FORUM REPORT

# **CREDIT ENHANCEMENT: REDUCING AND RATING CORPORATE BONDI RISKS**

**A. BOND COLLATERAL**

**B. GUARANTEES**

**C. BOND RATING AGENCY**

# RISK ENHANCEMENT: BOND COLLATERAL

--WHAT CATEGORIES OF COLLATERAL MAY BE PLEDGE

1. MORTGAGE LOANS
2. REAL PROPERTY
3. COMPANY SHARES
4. OTHER ASSETS

--WHAT ARE THE MECHANISMS TODAY TO REGISTER  
PLEDGES OF COLLATERAL ?

--WHAT ARE THE OBSTACLES TO PLEDGING COLLATER.  
IN FAVOR OF A POOL OF BONDHOLDERS ?

--WHAT ARE POSSIBLE REMEDIES TO PERMIT ACTIVE  
ISSUANCE OF COLLATERALIZED BONDS ?

# **RISK ENHANCEMENT: GUARANTEES**

--DCA GUARANTEES: WHAT ARE THE CIRCUMSTANCES WHERE A DCA GUARANTEE MAY APPLY TO A PROJECT (BOND ISSUE) ?

--OTHER GUARANTEES: WHAT TYPES MAY APPLY IN JORDAN, AND IN WHAT CIRCUMSTANCES ?



# RISK ENHANCEMENT AND RATING

CREDIT RATING AGENCY:

--CONSENSUS: A DESIRABLE STEP

--HOW TO MAKE IT HAPPEN ?

--WITHIN WHAT REGULATORY FRAMEWORK SHOULD IT OPERATE

## **DEVELOPING A BROADER RANGE OF NEW FIXED-INCOME INSTRUMENTS**

POSSIBLE NEW INSTRUMENTS WHICH MAY BE  
INTRODUCED IN JORDON IN THE NEAR-TERM  
INCLUDE:

- MORTGAGE BONDS (BACKED BY MORTGAGE  
LOANS)
- COLLATERALIZED BONDS (BACKED BY REAL  
ASSETS, POSSIBLY OTHER ASSETS)
- COLLATERAL TRUST BONDS (BACKED BY  
COMPANY SHARES)
- COMMERCIAL PAPER

# ENCOURAGING NEW BOND ISSUERS

- NEW TYPES OF INSTRUMENTS  
WILL ASSIST
- EDUCATION OF ISSUERS  
(FINANCIAL MANAGERS)
- BUSINESS DEVELOPMENT BY  
INTERMEDIARIES (CORPORATE  
FINANCE ADVISORY FUNCTION)

## **BRINGING NEW INVESTOR CATEGORIES TO THE MARKET**

**--RETAIL INVESTORS: WHAT STEPS ARE NEEDED ?**

**--INSURANCE SECTOR**

**--PRIVATE PENSION FUND SECTOR**

# **PRICING: DEFINING THE YIELD CURVE**

--ROLE OF TREASURY BILL AND BOND ISSUES AND MARKETS IN DEFINING THE YIELD CURVE.

--WHAT SHOULD BE DONE TO DEVELOP YIELD CURVE PARAMETERS ?

## **IMPROVING LIQUIDITY: ACTIVATING THE SECONDARY MARKET**

**--WHAT STEPS NEED TO BE TAKEN  
TO ACTIVATE THE SECONDARY  
MARKET ?**

# LEGAL AND REGULATORY STEPS NEEDED

WHAT ARE THE LEGAL OR REGULATORY  
STEPS NEEDED TO PERMIT NEW BOND  
INSTRUMENTS:

- MORTGAGE BONDS
- COLLATERALIZED BONDS
- COMMERCIAL PAPER

WHAT OTHER STEPS MIGHT BE NEEDED TO  
ACHIEVE OTHER OBJECTIVES (SECONDARY  
MARKET ETC) ?

# RECOMMENDATIONS FOR ACTION TO BE TAKEN

WHAT ACTIONS OR COMMENTS  
SHOULD BE INCLUDED IN THE  
FORUM REPORT ?



REPUBLIC OF BULGARIA  
NATIONAL ASSEMBLY

**MORTGAGE-BACKED BONDS ACT**

*Promulgated, SG No. 83 of 10 October 2000*

**Chapter One  
GENERAL**

**Article 1**

This Act shall regulate the terms and procedure for the issuance and redemption of mortgage-backed bonds.

**Article 2**

- (1) Mortgage-backed bonds shall be securities that are issued by banks on the basis of their loan portfolio and that are secured by one or more first mortgages on real property in favour of the banks (mortgage loans).
- (2) The real properties under paragraph (1) must be insured against destruction and may be of the following types:
  1. Housing units, including leased out;
  2. Villas, seasonal and holiday housing;
  3. Commercial and administrative office space, hotels, restaurants and other similar real property;
  4. Industrial and warehousing premises.

**Article 3**

Securities issued under procedures other than the one laid down by this Act may not be referred to with, or include in their appellation, the expression 'mortgage-backed bond', or any other combination of these words.

**Article 4**

Any officials who have violated this Act shall be held liable jointly and severally with the issuing bank for any damages ensuing from such violation.

**Chapter Two  
MORTGAGE-BACKED BOND COVER**

**Article 5**

- (1) Mortgage-backed bonds outstanding shall be backed by mortgage loans of the issuing bank (principal cover).
- (2) To substitute any loans from the principal cover that have been retired in full or in part, the issuing bank may include the following of its assets in the cover of mortgage-backed bonds (substitution cover):
  1. Cash in hand or with the Bulgarian National Bank and/or commercial banks;
  2. Claims on the Government of the Republic of Bulgaria or the Bulgarian National Bank, and claims fully secured by them;
  3. Claims on governments or central banks of states as identified by the Bulgarian National Bank;
  4. Claims on international institutions as identified by the Bulgarian National Bank;

5. Claims fully backed with government securities issued by the Government of the Republic of Bulgaria, the Bulgarian National Bank, the governments, central banks or international institutions listed in subparagraphs (3) and (4);
6. Claims secured by gold;
7. Claims fully backed by deposits with the bank denominated in Bulgarian leva or in a foreign currency for which the Bulgarian National Bank quotes a central rate every banking day.

#### **Article 6**

- (1) Mortgage loans are included into the calculation of the principal cover at the value of their principal outstanding, but at no more than 80 per cent of the mortgage appraisal value of the real property under Article 2, paragraph (2), subparagraph (1), and at no more than 60 per cent of mortgage appraisal value of real property under Article 2, paragraph (2), subparagraphs (2), (3) and (4) that serves as their collateral.
- (2) Substitution cover of mortgage-backed bonds from any given issue may not exceed 30 per cent of the total amount of liabilities of the issuing bank under that issue.
- (3) The cover of mortgage-backed bonds from any given issue (the sum total of the principal cover and the substitution cover) may not be less than the total amount of liabilities towards the principals of mortgage-backed bonds from that issue that are outstanding and in circulation outside the issuing bank.
- (4) In making the calculations under the subparagraphs above for mortgage-backed bonds and assets constituting their cover denominated in different currencies, the official foreign exchange rates for the Bulgarian lev to the respective currencies quoted by the Bulgarian National Bank as for the day of the calculation shall apply.

#### **Article 7**

- (1) The issuing bank shall keep a public register of the cover of mortgage-backed bonds issued by it.
- (2) The register shall be kept separately by mortgage-backed bonds issue.
- (3) The issuing bank shall adopt internal rules on the contents, the recordation and deletion procedures and the keeping of the register.
- (4) The issuing bank shall adopt internal rules on the terms and procedure authorizing access to the register.

#### **Article 8**

- (1) Bondholder claims under mortgage-backed bonds from each issue shall be secured by a first pledge on the assets of the issuing bank that are included in the cover of that issue.
- (2) The pledge shall be subject to recordation with the Central Register of Special Pledges, with the respective issue of mortgage-backed bonds being indicated as the pledge creditor.
- (3) The issuing bank shall be obligated to request recordation and to submit to the Central Register of Special Pledges all data necessary for the recordation of the pledge within one month of executing a mortgage-backed bonds issue, and to update those data at least once every six months thereafter.
- (4) The pledge shall remain in force until the full redemption of the liabilities of the issuing bank under the respective issue of mortgage-backed bonds, without the need for any renewal.
- (5) Deletion of the pledge recordation shall be made upon the full retirement of any liabilities of the issuing bank under the respective issue of mortgage-backed bonds, on the basis of a document issued by the bank's auditors.

#### **Article 9**

- (1) Assets recorded in the register as cover for mortgage-backed bonds of any given issue may be used as collateral solely for the liabilities of the issuing bank under that issue.
- (2) The issuing bank may not allow any encumbrances on its assets constituting the cover for mortgage-backed bonds outstanding except in observance of the procedure set under Article 8

### **Article 10**

The issuing bank shall account for any assets recorded in the register of mortgage-backed bonds cover separately from the rest of its assets.

## **Chapter Three**

### **ISSUANCE AND REDEMPTION OF MORTGAGEBACKED BONDS**

### **Article 11**

- (1) In public offerings of mortgage-backed bonds, the provisions of the Public Offering of Securities Act and the Regulations on its implementation shall apply.
- (2) In offering mortgage-backed bonds in cases other than the case set out under paragraph (1), the provisions of the Commercial Act shall apply.

### **Article 12**

The offering or the draft prospectus for an issue of mortgage-backed bonds shall contain additional data valid as of the time of their preparation, as follows:

1. The Rules of the issuing bank under Article 7, paragraphs (3) and (4), and its internal rules on conducting and documenting mortgage appraisals;
2. Data on the mortgage loans held in the issuing bank's portfolio on the basis of which an issue is being made, including, for each loan:
  - a) The size of the principal outstanding as of the time of making the loan and as of the end of the most recent full quarter;
  - b) Loan life as of the time of making the loan and the time to maturity remaining;
  - c) Interest rates, fees and commissions on the loan;
  - d) Risk classification of the loan as of the end of each calendar year from the time it was made and as of the end of the most recent full quarter;
  - e) Type of real property mortgaged as collateral in accordance with Article 2, paragraph (2), their mortgage appraisal value and the ratio between the principal outstanding and the mortgage appraisal value as of the time of making the loan and as of the end of the most recent full quarter;
3. Characteristics of the mortgage loan portfolio on the basis of which the issue is made, including a distribution of loans by:
  - a) Size of the principal outstanding;
  - b) Time remaining to the final repayment of the loan;
  - c) Interest levels;
  - d) Their risk classification as of the end of the most recent full quarter;
  - e) The ratio between the principal outstanding and the most recent mortgage appraisal value of the real property pledged as collateral.

### **Article 13**

The State Securities Commission shall rule on the application for confirming a prospectus for an issue of mortgage-backed bonds following the procedure set in Articles 91 and 92 of the Public Offering of Securities Act.

### **Article 14**

A loan recorded in the register of the cover of mortgage-backed bonds from any given issue may be retired at any time through bonds of that same issue at their face value.

## Chapter Four

### MORTGAGE APPRAISAL VALUE OF A REAL PROPERTY

#### Article 15

Mortgage appraisal value of a real property shall be the cash value at which the real property can be sold as of the time of the appraisal.

#### Article 16

- (1) For the purposes of a mortgage appraisal under this Act, the comparative method, the revenue method and the cost-to-make method.
- (2) A mortgage appraisal must specifically state:
  1. The method or combination of methods used as set out in paragraph (1), with the relative weight of each method in the value;
  2. The sources of data used in the analysis and in the calculations

#### Article 17

Mortgage appraisals of real property shall be performed by officers of the issuing bank or by natural persons designated by it and having the relevant qualifications and experience.

#### Article 18

Subsequent mortgage appraisals of real property serving as collateral for the loans recorded in the register of the cover of mortgage-backed bonds shall be performed at least once every twelve months for loans that:

1. Have liabilities outstanding that exceed 1 per cent of the issuing bank's owner's equity or
2. Have not been consistently classified as regular risk exposures throughout that period.

## Chapter Five

### REDEMPTION OF MORTGAGEBACKED BONDS IN CASE OF BANKRUPTCY OF THE ISSUING BANK

#### Article 19

- (1) In case of declaring the issuing bank bankrupt, the assets recorded, as of the date of declaring the bank bankrupt, in the register of the mortgage-backed bonds cover shall not be included in the bankruptcy estate.
- (2) Proceeds from the liquidation of assets recorded in the register as cover for any given issue of mortgage-backed bonds shall be distributed among the bondholders from that issue in proportion to the rights under their bond holdings.
- (3) Any funds remaining after resolving the claims under mortgage-backed bonds from any given issue shall be included in the bankruptcy estate.

#### Article 20

- (1) The asset pool under Article 19, paragraph (1) shall be managed by a trustee of the holders of mortgage-backed bonds.
- (2) The trustee shall be appointed by the bankruptcy court when it has been established that the bank has liabilities outstanding under mortgage-backed bonds.

#### Article 21

- (1) The trustee shall be a person meeting the requirements set in Article 217, paragraph (1) and paragraph (2), subparagraphs (1) through (3) of the Public Offering of Securities Act and who is not engaged in any relationship with the issuing bank or any of the holders of mortgage-backed bonds that give reasonable doubt as to the former's impartiality.
- (2) The trustee shall enjoy the powers of a receiver in relation to the assets defined in Article 19, paragraph (1) and in relation to any liabilities outstanding of the issuing bank under mortgage-backed bonds.

### Article 22

- (1) The trustee shall manage the assets defined in Article 19, paragraph (1) by individual mortgage backed bonds issues.
- (2) The trustee shall sell the assets following the procedure outlined in Articles 375 through 389 of the Civil Code of Procedure and shall refer any proceeds to an escrow account set up for each issue with commercial banks as determined by the Bulgarian National Bank.
- (3) The trustee must post an announcement stating the place and time for the tender referred to under paragraph (2) in the State Gazette and in at least two national daily newspapers not later than one month prior to the date of holding the tender.

### Article 23

- (1) The bondholders from any given issue of mortgage backed bonds of a bank that has been declared bankrupt shall have the right to obligate the trustee to sell loans included in the issue cover to a buyer of their choice.
- (2) The trustee shall be obligated to fulfil precisely the terms set in the decision of the general meeting of bondholders referred to in paragraph (1).

### Article 24

The liabilities of the issuing bank under a mortgage backed bonds issue shall be deemed retired when the amount of any principals outstanding under the sold loans becomes equal to the total amount of any liabilities under principals and interest accrued on the bonds as of the time prior to beginning the sales.

## ADDITIONAL PROVISIONS

§ 1. In the meaning of this Act:

1. "Comparative method" in preparing a mortgage appraisal of a real property shall be an analysis of the value of the appraised real property based on a comparison with prices realized at recent sales of real properties with similar features; an appraisal using this method includes data about the features and location of comparable properties, the times the sales were made at the indicated prices and the sources of information about such sales;
2. "Revenue method" in preparing a mortgage appraisal of a real property shall be an analysis of the value of the appraised real property based on its revenue generation capacity, in two scenarios: by compounding the net income from the property over a given period, or by discounting, for a certain number of periods, of cash flows resulting from the use of the property; an appraisal using this method includes data, in the first case, about the sources of information about the net income from the property and about the method of determining the compounding rate, and, in the second case, about the sources of information and the composition of cash flows, the period of discounting, the method of determining the ending value and the discount rate;
3. "Cost-to-make method" in preparing a mortgage appraisal of a real property shall be an analysis of the value of the appraised real property based on the possible cost for its creation (replacement) as of the time of the appraisal, increased by the cost of the land or the cost of building rights and any improvements made, decreased by accumulated depreciation; an appraisal using this method includes data about the sources of information about the parameters indicated.

§ 2. (1) Classification of risk exposures, risk classification of loans referred to under Article 12, subparagraph (2), item (d) and subparagraph (3), item (d), and Article 18, subparagraph (2) shall be done in observance of the requirements laid down in a Regulation issued by the Bulgarian National Bank.

- (2) The lists of governments, central banks and international institutions referred to under Article 5, paragraph (2), subparagraphs (3) and (4) shall be established by the Bulgarian National Bank in a Regulation on the capital adequacy of banks.
- (3) The issuing bank shall adopt internal rules on conducting and documenting mortgage appraisals of real property referred to under Chapter Four that must comply with the requirements of Article 41, paragraph (2) of the Banking Act.

### TRANSITIONAL AND CLOSING PROVISIONS

- § 3. In the Additional Voluntary Pension Insurance Act (promulgated, SG, No. 65 of 1999.; amended, Nos. 110 and 111 of 1999, Nos. 1 and 64 of 2000), the following amendments shall be made:
1. In Article 44:
    - a) In paragraph (1), subparagraph (4), at the end, "and mortgage-backed bonds issued by banks" shall be added;
    - b) In paragraph (2), at the end, "and mortgage-backed bonds issued by banks" shall be added.
  2. In Article 45, subparagraph (2), at the end, "except for securities issued under the Mortgage backed Bonds Act" shall be added.
  3. In Article 46, a new paragraph (3) shall be set up, to read:

"(3) A pension insurance company may invest up to 10 per cent of the pension fund's assets in securities issued by one and the same company, in case of securities under the Mortgage backed Bonds Act."
- § 4. In Article 52, paragraph (1), subparagraph (5) of the Insurance Act (promulgated, SG, No. 86 of 1996; amended, No. 1 of 1997; No. 21 of 1997 – Constitutional Court Decision No. 6 of 1997; amended, No. 58 of 1997, Nos. 21, 52, 93 and 132 of 1998, No. 88 of 1999), at the end, "mortgage-backed bonds issued under the Mortgage-backed bonds Act" shall be added.

# REPUBLIC OF BULGARIA

## LAW FOR PUBLIC OFFERING OF SECURITIES

(EXERPT: AMENDMENT OF 2002 PROVIDING FOR COLLATERAL TO BE PLEDGED IN FAVOR OF BONDHOLDERS, AND RELATED PROCEDURES)

### Section V. (new – SG 61/02)

Art. 100a. (new – SG 61/02) (1) Primary public offering of secured bonds shall be admitted if the issuer has concluded contract with agent of the bond holders. Art. 208, art. 209, para 2 and art. 210 – 213 of the Commercial law shall not apply.

(2) The agent of the bond holders shall act on behalf of himself in the cases, determined in this law and in the contract of para 1.

(3) The remuneration for the agent shall be for the account of the issuer.

(4) The requirement of para 1 shall not apply for bonds, issued under the Law for the mortgage bonds.

(5) The requirement of para 1 shall apply for not secured bonds if this is provided in the decision of art. 204, para 3 of the Commercial law for issuing of bond loan.

(6) The owners of bonds from one issue or class can solve issues of mutual interest at a general meeting. The general meeting shall be summoned by the agent of the bond holders by the order of art. 214 of the Commercial law.

Art. 100b. (new – SG 61/02) (1) The prospectus for issue of bonds must contain:

1. the conditions, under which the issuer is obliged to pay ahead of time the bond loan;

2. obligation of the issuer to observe certain financial indices till the redemption of the bond loan, including maximum value of the ratio liabilities to assets in the accounting balance sheet and minimum value of coefficient of coverage of the expenses for interests;

3. the conditions, which must be met by the issuer for issuing of new bond issues of the same class.

(2) The coefficient coverage of the expenses for interests of para 1, item 2 is calculated by dividing the profit of the usual activity, increased with the expenses for interests, by the expenses for interests.

(3) In the cases when the issuer has not concluded contract with agent of the bond holders, he shall be obliged to publish in the bulletin of the regulated market,

where the bonds are traded, and to present to the commission six months report about observing the conditions of the bond loan in 30 days after the end of each six months period. The report shall contain information about:

1. the observing of the obligations of the issuer to the bond holders according to the conditions of the issue, including the observing of the defined financial indices;
2. spending of the resources of the bond loan;
3. other circumstances, determined with an ordinance.

Art. 100c. (new – SG 61/02) (1) The agent of the bond holders shall be obliged to act for the best interest of the bond holders.

(2) The clauses, with which is excluded or restricted the responsibility of the agent to the bond holders in case of negligence, shall be void.

(3) The agent shall not be responsible before the bond holders for the damages, incurred by them, when his actions or lack of action are in fulfilment of a decision of the general meeting of the bond holders, taken with majority more than 1/2 of the votes of the bond holders, recorded the loan.

Art. 100d. (new – SG 61/02) (1) Agent of the bond holders can be only commercial bank with headquarters in the country or a bank, implementing activity in the country through a branch, licensed by the Bulgarian National Bank.

(2) Agent of the bond holders cannot be a commercial bank:

1. which is beneficiary of the issue of bonds or agent of bonds from other class, issued by the same issuer;
2. which controlled directly or indirectly or is controlled directly or indirectly by the issuer of the bonds;
3. in other cases, in which there is or can occur significant conflict of interests between the bank or a person, who controls it, and the bond holders.

(3) In case some of the circumstances of para 2 occurs after the concluding of the contract of art. 100a, the agent of the bond holders shall be obliged immediately to inform the issuer of the bonds and to remove the non compliance with the law in 30 days after the circumstance occurs. When the non compliance cannot be removed, the issuer of the bonds shall be obliged to terminate the contract with the agent of the bond holders not later than 45 days after the non compliance occurs and to conclude a new contract of art. 100a with another person. The agent shall continue to fulfil his obligations to the bond holders till the new contract is concluded.

(4) The provision of para 3 shall be applied respectively also in the cases, when the permit for implementing of activity of the agent of the bond holders has been withdrawn, a decision for its voluntary liquidation has been taken or a procedure for insolvency has been opened for it.

Art. 100e. (new – SG 61/02) (1) The contract of art. 100a must fully determine the rights and the obligations of the agent of the bond holders to the issuer



of the bonds, the obligations of the agent to the bond holders, as well as the obligations of the issuer to the agent of the bond holders.

(2) The contract of art. 100a shall be part of the prospectus of the bond issue.

Art. 100f. (new – SG 61/02) (1) The issuer of the bonds shall be obliged:

1. to concede to the agent of the bond holders the information of section IV in the respective terms;

2. to concede to the agent of the bond holders till the 10th day of the month, following each quarter, report about the fulfilment of his obligations according to the conditions of the bond issue, including about the spending of the resources of the bond loan, about observing of the defined financial indices and about the status of the security;

3. to inform at latest till the end of the following working day the agent of the bond holders about:

a) all changes of the established security of the bond issue, including about the essential changes in the value of the possessions, subject of the security;

b) violation of the obligation to observe the financial indices, determined in the contract.

(2) The issuer shall concede the report of para 1, item 2 also to the commission, as well as to the regulated security market, where the bonds are traded.

Art. 100g. (new – SG 61/02) (1) The agent of the bond holders shall be obliged:

1. regularly to analyse the financial status of the issuer of the bonds with regard to the ability to fulfil his obligations to the bond holders;

2. in 30 days after the end of each six months to publish in the bulletin of the regulated market, where the bonds are traded, and to concede to the commission a report about the past period, containing the information of art. 100b, para 3, as well as information about:

a) the status of the securities of the bond issue, when such conditions exist;

b) the financial status of the issuer of the bonds with regard to the ability to fulfil his obligations to the bond holders;

c) the actions, implemented by him in fulfilment of his obligations;

d) the existence or the lack of circumstances under art. 100d, para 2;

3. regularly to check the existence and the status of the security;

4. to answer in writing to questions of the bond holders in connection with the issue of bonds.

(2) Upon non fulfilment of obligation of the issuer according to the conditions of the issue of bonds the agent of the bond holders shall be obliged:

1. to publish in the bulletin of the regulated market, where the bonds are traded, and to concede to the commission notification about the non fulfilment of the issuer and the actions of item 2, which the agent is undertaking;

2. to undertake the necessary actions for protection of the rights and the interests of the bond holders, including:

- a) to require from the issuer of the bonds to concede additional security in amount, necessary to guarantee the interests of the bond holders;
  - b) to inform the issuer of the bonds about the extent of the bond loan, which becomes exigible in case of deferred payment of certain part of the pecuniary obligations to the bond holders;
  - c) to proceed to extra-judicial execution with the security of the issue of bonds in the cases, admissible by the law;
  - d) to propose claims against the issuer of the bonds;
  - e) to submit application for opening of insolvency procedure for the issuer of the bonds.
- (3) The agent shall have right to access to the book of the bond holders, which interests he represents.

Art. 100h. (new – SG 61/02) (1) The receivables of the bond holders can be secured with pledge, mortgage or in another way, as secured creditor being pointed out the agent of the bond holders.

(2) Commercial companies cannot be pledged for securing the receivables of the bond holders.

(3) In favour of the bond holders can be established only first in order pledges and mortgages.

Art. 100i. (new – SG 61/02) (1) Primary public offering of issue of bonds, for which security is provided, shall be admitted after the establishing of the security.

(2) The requirement of para 1 shall not be applied, when the security is proprietary, acquired with resources, gathered from bond loan. Till the acquisition of the possession the gathered resources shall be preserved in bank account on the name of the agent. The agent shall follow the establishing of the security according to the conditions of the contract of art. 100a.

(3) At establishing of the security, as well as at least once in the year till the redemption of the bond loan, the issuer shall assign to experts with the necessary qualification and experience the implementation of valuation of the pledged and mortgaged possessions at market price. The agent of the bond holders can assign for the account of the issuer the implementation of valuation of the possessions – subject of the security, also when there are circumstances, on the basis of which it can be considered that significant decrease of its value have occurred.

(4) The initial valuation of the security of para 1 shall be attached to the prospectus of the issue of bonds and in the other cases the valuations shall be attached to the reports of the issuer about fulfilment of his obligations for the loan.

**BULGARIA**  
**Special Purpose Investment Companies**  
**LAW**

**Part One**  
**GENERAL PROVISIONS**

**Art.1.** This law shall regulate the relationships with respect to securitization of real property and receivables through companies that are licensed to act as special purpose investment companies, their establishment, activities and termination.

***Aims***

**Art. 2** This law is aimed at:

1. Creating conditions for development of investments through securitization of real property and receivables and further development of the capital market;
2. To guarantee protection of the investors' interests in the special purpose investment companies.

**Part Two**  
**ESTABLISHMENT AND LICENSE OF THE SPECIAL PURPOSE**  
**INVESTMENT COMPANY**

***Definition***

**Article 3.**

(1) The Special Purpose Investment Company is a joint stock company, which under the terms and conditions of this Law shall invest the funds raised by issuance of securities in real property or receivables (securitization of real property and receivables).

(2). The wording "special purpose investment joint-stock company" or the abbreviation "SPIC" shall be included in the name of the special purpose investment company.

(3). Entities, which do not comply with the requirements of this law, may not include in their names the wording "special purpose investment joint-stock company" or the abbreviation "SPIC".

***Scope of activities***

**Art.4.** The special purpose investment company shall carry out the following activities:

1. Raising funds through issuance of securities;
  2. Purchase of real property and ownership rights on the property, construction and renovation of property that is to be managed, rented, leased or sold, or purchase-sale of receivables.
- (2) The special purpose investment company may not enter into any other commercial transactions except those specified in par. 1, and directly related to their execution, unless permitted by this Law.
- (3) The special purpose investment company may not acquire real property or receivables, which are subject of disputes.
- (4) The real property, which is acquired by the special purpose investment company, shall be on the territory of the Republic of Bulgaria.
- (5) The receivables, which are acquired by the special purpose

investment company shall:

1. Be due by local entities;
2. Not be subject to foreclosure.

(6) A special purpose investment company cannot securitize both real property and receivables.

### ***Establishment***

Art. 6. (1) The special purpose investment company shall be established as provided in Art. 163 of the Commercial Act. The number of the establishers shall not exceed 50 persons.

(2) At least 30 % of the capital shall be subscribed by institutional investors to be established a special purpose investment company.

(3) Upon establishment of special purpose investment company the constitutional meeting must take a decision for initial increase of the capital with the same class of stocks as those subscribed at the constitutional meeting since the moment the company receives the license under Art. 11. The increase shall be in the amount of at least 30 % of the company's capital.

(4) The special purpose investment company shall inform the Financial Supervision Commission that it is entered in the commercial register within 7 days after the court decision is received.

### ***Capital and Stocks***

Art. 6 (1) The capital of the special purpose investment company shall not be less than 500 000 leva.

(2) The subscribed capital at the constitutional meeting shall be fully paid in as of the moment the application for entering in the commercial register is submitted.

(3) The capital contributions shall be made only in cash.

(4) The stocks of the special purpose investment company shall be book-entry. Art. 185, par.2 of the Commercial Act shall not apply.

(5) **The special purpose investment company may not issue preferred stocks**

(6) **The capital of the special purpose investment company may not be decreased by**

(7) Increase of the capital under Art. 197 of the Commercial Act shall not be permitted.

### ***By-laws***

Art. 7. Except the information provided in the Commercial Act. The by-laws of the special purpose investment company shall contain the following:

1. **the term, the company is founded for;**
2. type of assets to be securitized by the special purpose investment company;
3. investment strategy of the company;
4. limitations with respect to the type of real property, the company may invest in, and respectively to the type of receivables and collateral if such is provided;
5. maximum amount of the expenses for company's management as a ratio to the assets value as quoted in the balance sheet of the company;
6. rules for calculation of the remuneration of the board of directors members of the company, as well as the compensation of the servicing companies;
7. rights and obligations of the servicing companies.

### ***Management***

Art.8.(1) The special purpose investment company shall be managed and represented by Board of Directors.

(2) The members of the Board of Directors shall be holders of University degree and:

1. have not been convicted of crime or felony;
  2. are not declared insolvent as sole proprietors or as partners with unlimited liability in a company and are not subject to insolvency procedure;
  3. Have not been members of management or supervisory body of companies, which have been terminated due to insolvency for the last two years preceding the insolvency court decision date, if the claims of the creditors have not been satisfied;
  4. Have not been restricted from the right to occupy managerial positions;
  5. Are not spouses, or relatives, in direct or lateral lineage up to the third degree either to each other, or to another member of the managing or controlling body of the servicing company
- (3) The requirements of par.2 shall apply for natural persons representing legal entities – members of the Board of Directors.
- (4) To certify the circumstances under par. 2 a declaration, diploma and police record report shall be represented by the members.

#### ***Raising and keeping of the funds***

Art. 9. (1) The monies raised by issue of securities shall be paid by the persons buying the securities into a special account of the company opened for special investment purpose.

(2) The funds and securities of the special purpose investment company shall be kept by bank-depositor.

(3) The bank-depositor shall carry out all payments on the account of the special purpose investment company, under the terms specified in the by-laws and the public offering of securities prospectus.

(4) The provisions of Art. 173 of the Public offering of securities law shall apply for the bank-depositor.

#### ***Profit Distribution***

Art. 10 (1) The special purpose investment company shall distribute as a dividend at least 90 % of the fiscal year profit.

(2) Dividends shall be paid within a period of 12 months following the end of the fiscal year.

(3) For the withheld tax under Art. 34, par. 1 of the Corporate Taxation Act, the special purpose investment companies, which are licensed by the Financial Supervision Commission shall issue a document which shall contain:

1. name, number and date of the document;
2. names and addresses of the persons – issuer and receiver of the document;
3. number under the national tax register and BULSTAT of the issuer and receiver of the document, and if the receiver is a natural person – the civil identification number of the person;
4. the amount of the dividend and the financial period it is paid for;
5. amount of the withheld tax;
6. type and date of the payment document, certifying the tax has been paid;

7. type and date of the payment document, certifying the dividend has been paid;

8. full name and signature of the persons – issuer and receiver of the document;

- (4) The document under par. 3 shall be issued in two copies, one of the copies for the company which has withheld the tax, the other copy for the person-receiver of the dividend.

### ***License***

Art. 11 (1) The Board of Directors' members shall submit an application in the Financial Supervision Commission to issue a license to the special purpose investment company in a form approved by the Commission not later than 6 months after the date of the SPIC is entered in the commercial register. The following documents shall be attached to the application:

1. By-laws and other incorporation acts;
2. Prospectus for obligatory increase of the capital by public offering of stocks under art.5, par.3;
3. Document certifying the requirements of art.8, par. 2 are met, for the members of the Board of Directors and the persons authorized to manage and represent the company;
4. Copy of the agreement with the bank-depositor;
5. Full names and data of the persons, who own directly or through related party over 5 % of the voting rights stocks; the persons shall represent declarations certifying the origin of the funds used for contributions of the subscribed stocks, containing information if the funds are borrowed, and data on the paid taxes for the last 5 years.

- (2) The Financial Supervision Commission shall grant a license and approve the prospectus within 1 month after the application is received, and in the event additional information and documents are required – within 14 day after the receipt.

- (3) The Financial Supervision Commission may refuse to grant a license in the following cases:

1. The prospectus for public offering of securities, the servicing company, the bank-depositor or the agreement under par. 1, item 4 do not comply with the requirements of either this law, the Public offering securities law or any other act for their implementation;
2. The persons, holders of over 5 % of the shares with voting rights, directly or through related parties, who have control over the company with their actions or influence; and may harm the investments' security;
3. The company does not comply with the requirements for minimum capital;
4. The members of the Board of Directors and the persons authorized to manage and represent the company do not meet the requirements under Art. 8, par.2;
5. Any other requirements of the law are not met, or the investors' interests are threatened.

### ***Prospectus.***

Art. 12. (1) The prospectus for public offering of securities of the SPIC shall contain information for the company, the activities and the stocks to be offered as provided by the provisions of the Public Offering of Securities law and other related acts, as well as:

1. Investment aims and limitations in the investment policy;
2. Detailed criteria to comply with for the real property, respectively the

receivables the company shall invest in, as well as the characteristics of the acquired real property, respectively receivables;

3. the other funding sources if such are envisaged;
4. the maximum amount of external funding as a ratio to own capital;
5. information of the bank-depositor and the requirements the servicing companies shall meet;
6. the amount or methods of calculation of remuneration to be paid to the Board of Directors and the servicing companies;
7. the maximum allowed amount of expenses for management of the company as a ratio to the assets value as stated in the balance sheet;
8. additional investments and expenses related to exploitation of assets;
9. additional facts and circumstances, specified in regulation of the Financial Supervision Commission;

(2) The Board of Directors members, company's procurator and the person signing the prospectus on behalf of the investment intermediary are jointly liable for any harm caused by false, misleading or incomplete information stated in the prospectus. The person under Art.34, par. 1 or 2 of the Accounting Law shall be jointly liable with the persons stated in the above sentence for any harm caused by false, misleading or incomplete information in the financial reports of the SPIC, and the registered auditor – for any harm, caused by the audited balance sheet.

#### ***Initial Increase of the Capital***

**Art. 13. (1)** Initial increase of the capital of the special purpose investment company shall be done only further to an approved by the Financial Supervision Commission prospectus. Art. 112a, par. 1 of the Public Offering of Securities Law shall not apply.

**(2)** With the initial increase of the capital certain rights are granted as per § 1, item 3 of the Public Offering of Securities Law. Against each stock of the increase only one right is granted.

**(3)** The initial increase of the capital shall be serviced by investment intermediary with amount of the capital not lower than the provided amount under Art. 56, par. 1 of Public Offering of Securities Law. The whole issue of rights under par. 2 shall be undertaken by the investment intermediary and shall be **offered to a regulated market**. The provisions of Art. 112, par. 1 of the Public Offering of Securities Law and Art. 194 of the Commercial Act shall not apply upon initial increase of the capital.

**(4)** The special purpose investment company shall send a notification to the regulated market the securities are to be offered at. The notification shall contain the date the offering of the rights shall start, the terms of its execution, and information of the number, the book value and issue value of the stocks to be subscribed.

**(5)** The notification under par. 4 shall be sent not later than 30 days of the date the special purpose investment company is granted a license.

**(6)** The regulated market shall accept for trade the rights under par. 2.

**(7)** The subscribing term under par. 1 is at least 30 days. The start of the subscribing term shall coincide with the start of the term for transfer of the rights. The subscribing term shall expire at least 15 business days after the term for transfer of the rights has expired.

**(8)** Initial increase of the capital shall be executed up to the amount of the subscribed stocks.

#### ***Change of the company in the event a license is not granted***

**Art. 14 (1)** The Financial Supervision Commission shall send to the Court,

which registers the SPIC a valid refusal to grant a license.

(2) In the event the Financial Supervision Commission has not received the application under Art. 11, par. 1 within 6 months term as of the date of the registration of the SPIC, the Commission shall notify the Court.

(3) Upon notification under par. 1 or 2, the registration court shall ... .. Change the name of the special purpose investment company, as the wording “special purpose investment company” or the abbreviation SPIC shall be replaced with Joint Stock Company, respectively JSC.

#### ***Change of constitution and management***

**Art. 15. (1)** Change in the by-laws and other incorporation acts of the special purpose investment company, as well as replacement of the bank-depositor and the servicing company shall be permitted with approval of the Financial Supervision Commission.

(2) The Financial Supervision Commission shall grant or refuse to grant the approval under par. 1 in 14 days the application with the attachments is received, and in case additional information is required – in 14 days of the receipt. The Commission refuses to grant an approval in the event the requirements of the law and the applicable acts are not met. The refusal shall be motivated in writing.

(3) The court shall enter in the commercial register the change in the by-laws after the approval under par. 1 is presented.

#### ***Suspension of license***

**Art. 16 (1)** The Financial Supervision Commission shall deprive the license it has granted, if the special purpose investment company:

1. has not started to execute the permitted activity in 12 months as of the date the license is granted;
2. has presented false information which has served as grounds for issue of the license;
3. has failed to comply with the requirements the license is granted at;
4. systematically violates the regulations of this law or other applicable acts.

(2) The Financial Supervision Commission shall notify the company in writing in 7 days after the decision for suspension of license is taken.

(3) After the suspension of license decision is taken the Financial Supervision Commission shall immediately require the respective state court to initiate a liquidation procedure of the special purpose investment company and shall undertake all necessary actions to inform the public.

### **Chapter Three**

### **REQUIREMENTS TO THE ACTIVITIES OF SPIC**

#### ***Due care***

**Art. 17. (1)** Asset management of a special purpose investment company shall be carried out in good faith and due care while abiding by the principles of protection of the shareholders interests and maintaining of optimum correlation of reliability and profitability.

(2) The Board of Directors' members of the SPIC shall insure the real property immediately after acquisition.

#### ***Servicing companies***

**Art. 18. (1)** The special purpose investment company may not directly exploit and maintain the acquired real property or collect the acquired receivables.

**(2)** The special purpose investment company may enter into



contract(s) with company or companies that have the necessary organization and resources (servicing companies) for the service and maintenance of the acquired real property, construction and refurbishment, respectively the service of the acquired receivables, the keeping of accounting, reporting and correspondence, as well as any other necessary activity.

(3) The servicing companies shall ensure the activities under par. 2 are carried out in compliance with the law and the by-laws of the SPIC.

(4) The servicing companies may not unilaterally withhold against their remuneration any amounts collected for the account of the special purpose investment company.

(5) The Financial Supervision Commission shall monitor the servicing companies pursuant to Art. 18 and 19 of the Financial Supervision Commission Law.

### ***Appraisal of Real Property and Receivables***

Art. 19. (1) Prior to acquisition of real property and receivables, the special purpose investment company shall assign a qualified and experienced appraiser/s to appraise the property and receivables.

(2) The appraisal may not be assigned to a person who:

1. Directly or indirectly holds stock of the special purpose investment company;

2. Is a member of the Board of Directors of the special purpose investment company;

3. Is a related party to a member of the Board of Directors or a person who holds directly or indirectly over 5 % of the stocks of the special purpose investment company;

4. Is a seller of the real property, member of managing or supervising body, partner or shareholder to the seller, as well as related party to the seller, to a member of the managing or supervising body, partner or shareholder;

5. May be influenced by other form of dependence or conflict of interests;

(3) The appraisers shall represent a declaration certifying the lack of circumstances under par. 2.

(4) The appraisers shall be liable for any harm caused to the company or its shareholders, which are result of their imprecise appraisal.

(5) The special purpose investment company may not sell or buy real property or receivables at prices significantly lower or higher than the appraised value, except in extraordinary circumstances. In such case the persons who manage and represent the company shall explain their actions and reasons in the next regular report.

### ***Follow-up appraisals of the real property and receivables***

Art. 20. The owned by the special purpose investment company real property and receivables shall be appraised at the end of each fiscal year or in the event there is a change of over 5 % of the price index of real property or the inflation index as quoted by the National Statistics Institute. Art. 19 shall be respectively applied.

### ***General Limitations***

Art. 21. (1) The special purpose investment company may not secure other person's obligations or extend loans.

(2) The special purpose investment company may:

1. Issue debt securities, registered for trade at a regulated market;

2. Borrow bank credits to acquire and start exploitation of the assets to be securitized;

3. Borrow bank credits in the amount of up to 20 % of the balance assets value, which is to be used for payment of interests if the term of the credit is longer than 12 months.

(3) The special purpose investment company may invest up to 10 % of its own capital in a servicing company.

#### ***Investing of free funds***

Art. 22. (1) The special purpose investment company may invest its free funds in securities, issued or guaranteed by the state and bank deposits.

(2) The special purpose investment company for securitization of real property may invest up to 10 % of its assets in mortgage bonds.

(3) The special purpose investment company may not acquire share holds in other companies, except in the cases under Art.21, par. 3.

(4) The special purpose investment company may not participate in the capital market as investor in assets which are different from those under par. 1 and 2, or execute purchase back as provided in art. 111, par. 5 of the Public Offering of Securities Law.

#### ***Limitations to acquisition of new assets for securitization***

Art. 23. The special purpose investment company may acquire new asset or assets for securitization only if this is provided for in the company by-laws and the prospectus for public offering of securities.

#### ***Protection of company's property***

Art. 24. Articles 646-649 of the Commercial Act shall not apply for real property and receivables, sold to the special purpose investment company, unless the deals are executed in violation of art. 4 and 19 of this law.

### **Chapter Four**

#### **DISCLOSING OF INFORMATION AND CONFLICT OF INTERESTS**

##### ***Disclosing of information***

Art. 25. (1) The special purpose investment companies for securitization of real property shall disclose in their quarterly and annual reports the information they are obligated to disclose as a public company as well as the following information:

1. Information on the share of assets lent against payment to the total amount of the securitized assets;

2. Information for sale or purchase of a new asset which value exceeds with 5 % the value of the securitized assets;

3. Other information required by order of the Financial Supervision Commission.

(2) The special purpose investment companies for securitization of

receivables shall disclose in their quarterly and annual reports the information they are obligated to disclose as a public company as well as the following information:

1. The share of past due receivables to the total amount of securitized receivables;
2. Type and amount of the collateral and term to receivables maturity for receivables which exceed 10 % of the total amount;
3. Average amount of the collateral to the total amount of the receivables;
4. Average term of payments for interests and principals of the securitized receivables;
5. Classification of receivables under the regulation of par. 1, item 3;
6. Other information under the regulation of par. 1, item 3.

(3) The special purpose investment companies which own shares or stocks in servicing companies shall include in their quarterly and annual reports financial reports of the servicing companies.

#### ***Conflict of interests***

Art. 26. (1) The persons who manage and represent the special purpose investment company shall perform their obligations in good faith with the due care to protect investors interests. The company's interest shall have priority over the personal interests.

(2) The persons under par. 1 shall submit a declaration every year to the Financial Supervision Commission of their property and business interests.

(3) The persons under par. 1 shall avoid conflict of their personal interests and the company's interest, and if such occur, they shall disclose it on time in a way acceptable for the investors and shall not participate in the taking of decisions in such cases.

(4) The persons who manage and represent the company shall keep the secrets of the company, even if they are neither managers nor representatives of the company anymore, till the public announcement of the respective circumstances.

#### **Chapter Five**

#### **Transformation and termination of the SPIC**

##### ***Transformation***

Art. 27. (1). The special purpose investment company shall not transform into any other type of company, neither change its scope of business activities.

(2) Transformation by merge shall be done with the permission of the Financial Supervision Commission only between special purpose investment companies, which securitize the same type of assets.

(3) Transformation by split shall be done with the permission of the Financial Supervision Commission and the newly established company/companies shall be special purpose investment company.

##### ***Termination.***

**Art. 28.** The special purpose investment company shall be terminated at the expiration of the term provided for in the by-laws or pursuant to a decision of the general meeting only on the grounds provided for in the by-laws and the prospectus for issuance of securities. The Financial

Supervision Commission shall permit the termination of the company. The persons assigned for liquidators and trustees of the special purpose investment companies shall be approved by the Financial Supervision Commission. Articles 68a and 69 of The Public Offering of Securities Law shall be applied respectively.

#### ***Issuance of Permit***

**Art. 29. (1)** An application for issuance of permit under art. 27 and 28 shall be submitted in a form approved by The Financial Supervision Commission. The Commission shall announce its opinion in 14 days after the application with the attachments is received, and in case additional information is required – in 7 days of the receipt. Articles 28, par. 2 and 3 of The Public Offering of Securities Law shall be applied respectively.

**(2)** The Financial Supervision Commission shall refuse issuance of permit for transformation or termination in the event the investors' interests are not protected. The applicant shall be notified in three days of the decision.

**(3)** The terms and the way for issuance of permit under art. 27 and 28 shall be regulated in order of the Financial Supervision Commission.

#### **Chapter Six**

**Art. 30.**